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SUBJECT: FRANCE REOPENS MONETARY DEBATE

REF: PARIS 2791

¶1. (SBU) SUMMARY. Although the euro has come off its recent highs against the U.S. dollar, President Nicolas Sarkozy is unlikely to give up efforts to convince Eurogroup partners that European governments should discuss European Central Bank (ECB) monetary and exchange rate policy. France, which has argued that the strong euro harms European exports, understands it is isolated on the issue, and Sarkozy underscored his support for ECB independence following his July 16 Toulouse meeting with Angela Merkel. But the GOF is likely to continue to look for opportunities to bruit its "economic government" idea, and to encourage discussion of currency and monetary policy issues in various inter-governmental fora. End of Summary.

France's Concern: Strong Euro Harms Exports

¶2. (U) President Sarkozy has regularly complained that certain trade partners of the EU practice "monetary dumping" by keeping currencies weak to boost exports. During the presidential campaign Sarkozy vowed to lobby for changes in the ECB's mandate so that it would take economic growth issues into account when setting policy. While he has toned down the rhetoric as president, he used his appearance at the Eurogroup meeting of finance ministers in early July to further stake out his position.

France Seeks to Convince its Partners on ECB Policy

¶3. (U) More recently the ECB was one of two topics discussed during Sarkozy's meeting with German Chancellor Angela Merkel in Toulouse on July 16. After the meeting, Sarkozy reportedly told his cabinet that Merkel's views on the euro had moved "closer to his." He said they both had agreed on the importance of maintaining the independence of the ECB, but also on the need to put "monetary dumping" on their common agenda.

¶4. (U) Sarkozy's spokesman Laurent Wauquiez explained that "the president is not questioning the independence of the central bank, but showing that monetary policy is a topic of debate and dialog." While in Toulouse, Sarkozy had quoted article 111 of the Treaty Establishing the European Community, saying the European Council "may formulate general orientations for exchange-rate policy." Sarkozy said then that it "isn't illegitimate for us to have a discussion on a subject which doesn't call into question the European Central Bank's independence. I'd even say that it doesn't call into question the level of the euro, but rather monetary dumping carried out by other parts of the world."

¶5. (SBU) Sarkozy appeared to back off from the issue in the run-up to his August vacation, and ECB President Jean-Claude Trichet was quoted in the press as saying he had had a "very good meeting" with

PM Francois Fillon on July 26. Nonetheless, European Affairs Minister Jean-Paul Jouyet has picked up the cudgel, first in a press interview and more recently before the National Assembly's Finance Commission on July 31. Jouyet told the press that "when you are evaluating a country's economic situation you have to consider the whole picture," indirectly reproaching the ECB for its focus on fighting inflation. He suggested that the Eurogroup might pursue a strategy of "(influencing) the ECB's decisions by having a more open discussion about the motivation behind interest-rates decisions. You can have those discussions discretely and in the framework of the Eurogroup." Jouyet told the National Assembly that existing dialogue between the ECB and Eurogroup governments was at times "simplistic" and needed to be expanded.

ECB Governor Promptly Reacts

¶6. (U) Already irritated by Sarkozy's repeated criticism, ECB Governor Trichet has taken to the French airways to reject GOF calls for greater political influence on the Bank. In an August 3 radio interview Trichet said that the existing dialogue with EU governments was "very well organized," that he saw his Executive Board "three times per month," and the European Parliament "at least five times per year." Trichet said the consultative process was organized according to the terms of the Maastricht Treaty, and that he would not deviate from that.

¶7. (U) Bank of France Governor Christian Noyer has also waded into the debate. In his August 2 introduction to the Bank's annual report (addressed to the president and to parliament), Noyer recalled that price stability was the overriding objective of all central banks "not by chance," but rather based on experience that shows that attempts to stimulate growth using expansive monetary policy "have always failed." Noyer wrote that the defense of the value of the currency "is the preservation of our purchasing

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power...which our compatriots understand, and is manifested in their attachment to price stability."

¶8. (U) France's economic growth is forecast to lag behind the eurozone for the second consecutive year in 2007, notably due to insufficient export growth (reftel). France posted a record 26.8 billion euro (33.6 billion USD) trade deficit in 2006. In 2007, French export growth has stagnated while German exports have reportedly risen to a new high. Noting that France and Germany share a common currency, EU Commission analysts put the blame on the lack of competitiveness of French companies. (Note: Exports to Europe account for 72.0 percent of French exports, of which 50 percent to the eurozone and 65 percent to the EU; exports to the United States and Asia account respectively for 6.7 percent and 8.8 percent of French exports. Imports from the U.S. increased 11.7 percent in 2006. Imports from Asia were up 24 percent in 2006 compared with 2004. End of Note.)

Strong Euro or Weak Dollar?

¶9. (U) French private-sector analysts generally have pinned the recent run-up in the euro on fears that the sub-prime mortgage crisis in the United States may undermine U.S. economic growth. Analysts here also expect the ECB, which has doubled its benchmark interest rate to 4 percent from 2 percent in late 2005, to further increase it to 4.25 percent in September and possibly 4.50 percent thereafter, putting further upward pressure on the euro. Some commentators suggest that a euro above USD 1.40 would begin to seriously weigh on competitiveness. According to Morgan Stanley senior economist (and member of the Prime Minister's Council of Economic Advisors) Eric Chaney, in that situation "only the ECB could break the vicious circle."

Comment

¶10. (SBU) President Sarkozy may have toned down the rhetoric, but we do not expect this issue to go away (particularly if the euro strengthens further). Although Finance Minister Lagarde has taken a relatively low profile in the debate, she has been formally tasked (in the president's "letter of mission" to her) to work with EU

partners towards an "economic government" that would encourage economic convergence, build a "real dialogue" with the ECB in order to give the euro zone a "monetary strategy," and to examine the extent to which an accord can be reached between the ECB and the Eurogroup on the "modalities" of implementing exchange rate policy.

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